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Tata Consultancy Services: Underperformance likely to continue. Maintain REDUCE

News Roundup

Corporate

- Warburg Pincus-controlled WNS Holdings is working on an outright acquisition or a strategic merger with rival outsourcing firm Firstsource Solutions, in which ICICI Bank holds 26.8% stake. (ET)
- For the first time since the controversy around BlackBerry broke out, Canada-based Research In Motion has broken its silence on the security concerns raised by the Indian Government and said that it is not possible for it to give decryption codes or set up a local data centre in the country. (BL)
- Tata Consultancy Services, India's top IT services company announced that it has bagged a \$100-million, five-year contract to deliver global IT application services to NXP Semiconductors. (BS)

Economic and political

- The growth of organized retail headed by large corporations does not significantly impact small mom-n-pop retailers, a long-awaited study by the Indian Council for Research on International Economic Relations concluded. The study conducted for the government, following allegations that big retail was squeezing neighborhood retailers out of business, showed that the latter's turnover and profit dropped 8 to 9% initially, but the adverse impact weakened over five years. (BS)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line.

EQUITY MARKETS

India	Change, %			
	26-May	1-day	1-mo	3-mo
Sensex	16,349	(1.8)	(4.5)	(8.3)
Nifty	4,875	(1.4)	(4.6)	(7.5)
Global/Regional indices				
Dow Jones	12,480	(1.2)	(3.2)	(1.6)
Nasdaq Composite	2,445	(0.8)	0.9	4.3
FTSE	6,087	(1.5)	(0.1)	(0.0)
Nikkie	13,803	0.8	(0.4)	(1.6)
Hang Seng	24,306	0.7	(4.7)	(0.7)
KOSPI	1,813	0.7	(0.6)	5.3
Value traded - India				
		Moving avg, Rs bn		
	26-May	1-mo	3-mo	
Cash (NSE+BSE)	165.9	205.5	193.9	
Derivatives (NSE)	441.0	338.3	565	
Deri. open interest	855.5	549	820	

Forex/money market

	Change, basis points			
	26-May	1-day	1-mo	3-mo
Rs/US\$	42.7	0	251	295
6mo fwd prem, %	0.7	(25)	71	24
10yr govt bond, %	8.2	2	(8)	50

Net investment (US\$m)

	23-May	MTD	CYTD
	FIs	(124)	6
MFs	4	(198)	1,394

Top movers -3mo basis

Best performers	Change, %			
	26-May	1-day	1-mo	3-mo
Shipping Corp	284	(2.6)	24.5	30.4
Thomas Cook	103	0.2	2.8	29.1
Nestle India	1,740	(1.8)	9.0	28.7
Dr Reddy's	690	0.4	11.9	27.3
i-Flex	1,349	(6.4)	1.3	22.8
Worst performers				
Thermax	430	(5.4)	(15.1)	(34.4)
Reliance Cap	1,277	(3.3)	(12.7)	(33.6)
SAIL	167	(3.4)	(5.9)	(31.6)
Siemens India	580	(1.4)	(10.0)	(30.6)
Essel Propack	33	(3.4)	(18.4)	(30.2)

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Banking**SRTR.BO, Rs343**

Rating	REDUCE
Sector coverage view	Attractive
Target Price (Rs)	335
52W High -Low (Rs)	472 - 144
Market Cap (Rs bn)	69.7

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	11.4	15.3	19.3
Net Profit (Rs bn)	3.9	5.2	6.6
EPS (Rs)	19.3	25.4	31.4
EPS <i>gth</i>	86.3	31.7	23.8
P/E (x)	18	13.5	10.9
P/B (x)	4.2	3.5	2.9
Div yield (%)	1.7	2.2	2.9

Shareholding, December 2007

	% of Pattern Portfolio	Over/(under) weight	
Promoters	42.0	-	-
FIs	13.2	0.1	0.1
MFs	3.4	0.2	0.2
UTI	-	-	-
LIC	-	-	-

Shriram Transport Finance: Strong core performance drives earnings

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- **STFC reported PAT (4QFY08) of Rs1.1 bn, up 131% yoy but 2% below estimates**
- **Net operational income up 102% to Rs3.7 bn—largely supported by enhanced net worth post IPO**
- **Core earnings above estimates—driven by strong loan growth, stable spreads but tempered by higher wages and operating expenses**
- **We will revise estimates after today's analysts meet, retain REDUCE**

Shriram Transport Finance's (STFC) core income (PBT excluding extraordinary items) was up 178% yoy, 10% above estimates. Healthy NIMs due to high loan growth and stable spreads backed by enhanced net worth post IPO were the key drivers. The reported earnings were marginally below estimates due to (1) high depreciation—the company reassessed useful life of its windmills and other assets, (2) higher wages and operating expenses and (3) higher tax liability likely due to fringe benefit tax (FBT). We will revise our earnings estimates after today's analysts meet. We retain REDUCE recommendation with a price target of Rs335. The stock is currently trading at 3.2X PBR and 13.5XPER FY2009E.

Key highlights

Strong traction in growth. STFC reported disbursements of Rs38 bn (up 112% yoy) mainly driven by used vehicles (Rs26 bn, up 193% yoy). Consequently, truck assets were up 62% yoy to Rs195 bn. In order to support its growth traction, STFC opened 45 new branches during 4QFY08 taking the total to 430. Its employee strength increased to 9,500 from 7,500 in December 2007. Consequently, wages were up 92% yoy (40% qoq) and other operating expenses were up 68% yoy (48% qoq).

NPL marginally lower. Asset quality was better as gross NPL ratio reduced to 1.6% from 2% in March 2007 and net NPLs to 0.9% from 1.2% in March 2007.

Reported loss from windmills. STFC operates 17 windmills aggregating to 25 MW. The company has reported segmental earnings from this business. STFC unallotted reconciling items (mainly windmills) reported marginal loss before tax of Rs89 mn for 4QFY08 and Rs95 mn for FY2008 on a capital of Rs526 mn. The segment would have likely reported a profit in 4QFY08, if the company had not reassessed the useful life of its windmills. Currently, this segment is very small for STFC and the company has no intentions to grow it.

Shriram Transport Finance - Quarterly results

1Q07-4Q08 (Rs mn)

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	YoY(%)	4Q08E	Actual vs KS (%)
Net operational income before provisions	1,325	1,705	1,907	1,829	2,329	2,734	2,920	3,696	102	3,257	13
Provision and credit costs	300	439	420	542	569	630	526	667	23	667	(0)
Net operational income after provisions	1,025	1,265	1,487	1,287	1,761	2,105	2,395	3,030	135	2,590	17
Other income	42	21	8	50	76	92	6	15	(70)	9	63
Total income	1,367	1,725	1,914	1,879	2,405	2,826	2,926	3,711	97	3,267	14
Operating expenses	435	592	620	645	697	726	784	1,272	97	856	49
Employee expenses	159	206	180	210	254	260	285	402	92	314	28
Other expenses	251	361	414	396	401	412	449	664	68	485	37
Depreciation	25	25	27	40	42	54	50	206	416	57	261
Due to reassessment								149			
Pretax income	632	694	874	692	1,140	1,471	1,617	1,773	156	1,743	2
Tax provisions	222	229	299	208	398	511	547	654	214	604	8
Net Profit	410	465	576	484	742	959	1,070	1,118	131	1,139	(2)
PBT(excl extraordinaries)	632	822	814	692	1,140	1,471	1,617	1,922	178	1,743	10
Tax rate (%)	35	33	34	30	35	35	34	37		35	
Other details											
Disbursements (Rs mn)	13,000	17,000	17,926	18,155	20,110	26,760	30,540	38,480	112	26,340	46
Pre-owned	8,155	11,530	12,341	8,945	14,468	20,270	22,003	26,200	193	19,250	36
New	5,442	5,470	5,585	8,288	5,648	6,490	8,537	12,280	48	7,084	73
O/s Truck assets (Rs mn)	63,452	68,060	80,964	83,830	95,846	118,790	118,004	151,190	80	124,170	22
Off balance sheet truck assets (Rs mn)	16,949	19,280	20,463	36,630	33,480	29,460	48,666	44,010	20	56,745	(22)
Total truck assets under management (Rs mn)	80,401	87,340	101,427	120,460	129,326	148,250	166,670	195,200	62	180,915	8
Yield on assets (%)	17.7	18.5	17.9	18.4	17.1	17.8	17.4	17.5			
old vehicle loans											
new vehicle loans											
Cost of funds (%)	10.5	10.7	10.3	11.7	10.0	11.1	11.3	10.8			
Difference (%)	7.2	7.8	7.6	6.7	7.2	6.7	6.2	6.7			
Gross NPLs(%)	2.05		1.21	1.97	2.07	1.9	1.6	1.6			
Net NPLs(%)	1.30		0.48	1.19	1.22	1.0	1.0	0.9			

Source: Company, Kotak institutional equities estimates.

Technology**TCS.BO, Rs955**

Rating	REDUCE
Sector coverage view	Neutral
Target Price (Rs)	950
52W High -Low (Rs)	1262 - 720
Market Cap (Rs bn)	935.0

Financials

March y/e	2008	2009E	2010E
Sales (Rs bn)	228.6	272.5	314.9
Net Profit (Rs bn)	50.2	56.6	64.0
EPS (Rs)	51.3	57.9	65.4
EPS <i>gth</i>	21.5	12.8	13.1
P/E (x)	18.6	17	14.6
EV/EBITDA (x)	15.2	12.9	11.2
Div yield (%)	2.1	2.4	2.7

Shareholding, December 2007

	% of	Over/(under)
	Pattern Portfolio	weight
Promoters	77.8	-
FIs	10.7	1.0 (1.0)
MFs	1.4	0.8 (1.3)
UTI	-	- (2.1)
LIC	2.2	1.2 (0.9)

Tata Consultancy Services: Underperformance likely to continue. Maintain REDUCE

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- **'Free transition'—cumulative impact of US\$10-12 mn in 4Q**
- **Revenues growth from North America BFSI clients likely to remain weak**
- **TCS will benefit partially from rupee depreciation; operating margin target is aggressive**

FY2009 would be a challenging year for TCS, in our view. High exposure to banking and finance vertical (and more importantly to troubled clients) and potential pricing pressure will lead to significant slowdown in earnings and growth rates. We view TCS' stable operating margin guidance for FY2009 as aggressive. We maintain our below industry revenue growth forecast of 20.7% and EPS of Rs57.9 (at Re/US\$ rate of 39.5). The stock, trading at 16.5X FY2009 earnings, may have limited downside but will continue to underperform our preferred picks, Infosys and Satyam, in the sector. **Maintain REDUCE rating.**

Revenues growth from North America BFSI clients likely to suffer. TCS indicates that revenues from North American BFSI clients are unlikely to grow in FY2009. Note that North American geography accounts for 60% of TCS' BFSI revenues; effectively 25% of the overall business of TCS is unlikely to grow in FY2009. However, TCS indicates that growth continues to be robust in Europe and verticals such as life sciences and utilities. TCS' growth expectations are pinned on recovery in the 2nd half.

We maintain our below consensus revenue growth forecast of 20.7% (US\$ terms) for FY2009E. TCS has a significant challenge on managing risks from high revenue contributing BFSI vertical. Our channel checks indicate that the company has several global investment banking names and top commercial banking clients in its Top 20 portfolio (Top 10 contributed 29% to FY2008 revenues). We understand that the IT budgets of many of these clients may have seen a decline of over 10%. We believe TCS' revenue growth may suffer in the near term.

"Free transition"—cumulative impact of US\$10-12 mn in 4Q; no incremental discounts given since. TCS management indicates that they offered free transition to three-four US BFSI clients resulting in cumulative impact of US\$10-12 mn in the March '08 quarter. The company indicates that they have not offered any discounts or freebies since.

TCS will benefit partially from rupee depreciation; operating margin target is aggressive. TCS has hedged its forex exposure through options (80%). Further, the company reduced hedges to US\$2.9 bn in the March '08 quarter. We expect participation of approximately 60% from the normalized benefits of rupee depreciation. We note that TCS had significant hedging gains of Rs2.4 bn in FY2008.

TCS expects FY2009 operating (EBIT) margin to remain stable at 23.5%. We find the assumptions optimistic given that the company's 4QFY08 margin of 22.8% was lower than FY2008 average. TCS is already running a tight ship and does not have any meaningful levers (peak utilization, flat to declining pricing) to reach the target operating margin levels. We forecast 60 bps decline in FY2009 OPM.

Valuations—stock may still underperform. TCS has underperformed the BSE IT Index by 4.2% over the past three months and is now trading at 17% discount to Infosys' FY2009 P/E multiple. Note that our estimates are based on Re/US\$ rate of 39.5 for FY2009. We believe a combination of likely weak June '08 quarter and continued uncertainty around key accounts will lead to muted returns despite recent underperformance.

TCS has the highest exposure to the BFSI vertical among the tier-I Indian IT services players

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08	3QFY08	4QFY08
BFSI revenues (US\$ mn)												
TCS	233	251	277	304	327	371	424	430	493	547	588	599
Infosys	173	187	201	214	240	279	317	319	335	373	399	387
Wipro	78	89	98	111	121	133	145	158	173	193	225	242
Satyam	64	73	75	82	90	95	92	96	102	115	120	127
% of revenues												
TCS	40.8	41.3	41.8	41.8	41.2	42.7	43.5	41.3	43.1	43.3	44.0	43.8
Infosys	36.3	35.7	36.0	36.0	36.4	37.4	38.6	37.0	36.1	36.5	36.8	33.9
Wipro	19.5	20.6	20.7	21.6	22.4	22.6	22.7	22.9	23.8	24.2	24.7	25.2
Satyam	27.0	28.7	28.0	28.8	29.7	28.6	25.6	24.7	23.8	23.8	22.4	21.8

Source: Companies, Kotak Institutional Equities.

TCS: Consolidated Income Statement (US GAAP), Rs mn, fiscal year-ends March

Rs mn	2006	2007	2008	2009E	2010E
Revenues	132,455	186,332	228,614	272,494	314,913
Cost of revenues	(71,720)	(104,126)	(126,194)	(152,739)	(179,710)
Gross profit	60,735	82,206	102,420	119,755	135,202
Selling, marketing, general & administrative expenses	(26,422)	(35,329)	(48,770)	(57,456)	(65,343)
Research and development	(419)	(433)			
EBIT (before amortization)	33,894	46,444	53,649	62,299	69,859
Other Income, net	190	1,944	4,450	3,873	5,655
Income bf taxes and minority interest	34,084	48,389	58,099	66,173	75,513
Income Taxes	(4,989)	(6,701)	(7,494)	(9,005)	(13,948)
Income before share of equity in affiliates	29,095	41,688	50,605	57,167	61,565
Equity in earnings of affiliate	16	44	8	4	4
Minority Interest	(279)	(417)	(424)	(532)	(535)
Income from continuing operations	28,831	41,315	50,189	56,640	61,034
Extraordinary items	-	-	-	-	-
Net Profit- Reported	28,831	41,315	50,189	56,640	61,034
EPS (Rs/ share)	29.5	42.2	51.3	57.9	62.4
Margins (%)					
Gross Profit margin	45.9	44.1	44.8	43.9	42.9
EBITDA Margin	27.7	27.2	26.0	25.2	24.3
EBIT Margin	25.6	24.9	23.5	22.9	22.2
NPM	21.8	22.2	22.0	20.8	19.4
Growth Rates (%)					
Revenues	36.2	40.7	22.7	19.2	15.6
Gross Profit	34.8	35.4	24.6	16.9	12.9
EBIT	25.9	37.0	15.5	16.1	12.1
Income bf taxes	23.1	42.0	20.1	13.9	14.1
Income before affiliates earnings	23.2	43.3	21.4	13.0	7.7
Income from continuing operations	22.4	43.3	21.5	12.9	7.8

Source: Kotak Institutional Equities estimates.

Kotak Institutional Equities: Valuation Summary of Key Indian Technology Companies

Company	26-May-08		Mkt cap.		EPS (Rs)			PER (X)			EV/EBITDA (X)			EV/Sales (X)		
	Price (Rs)	Rating	(Rs m)	(US\$ m)	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E
HCL Technologies	297	REDUCE	206,380	4,830	18.4	21.7	24.4	16.2	13.7	12.1	11.7	9.9	8.2	2.4	2.0	1.6
Hexaware Technologies	63	SELL	8,912	209	7.7	7.8	9.4	8.2	8.1	6.7	4.7	3.9	2.9	0.5	0.4	0.3
Infosys Technologies	1,885	BUY	1,082,019	25,325	79.1	94.7	108.1	23.8	19.9	17.4	19.1	15.4	12.7	6.0	4.7	3.8
Mindtree	473	BUY	18,538	434	26.1	32.5	38.5	13.8	14.5	12.3	15.1	10.5	8.3	2.6	1.9	1.4
Mphasis BFL	222	SELL	46,368	1,085	12.2	13.5	16.0	18.2	16.5	13.9	10.9	9.9	8.2	1.9	1.6	1.2
Patni Computer Systems	273	SELL	37,961	888	32.8	24.0	27.8	8.3	11.4	9.8	5.2	5.2	3.8	0.9	0.8	0.6
Polaris Software Lab	104	SELL	10,223	239	7.4	9.0	10.4	14.0	11.6	10.0	7.1	5.6	4.6	0.8	0.6	0.5
Satyam Computer Services	482	BUY	328,766	7,695	25.2	30.5	35.0	19.1	15.8	13.8	15.6	12.3	9.9	3.4	2.6	2.0
TCS	955	REDUCE	935,013	21,884	51.3	57.9	65.4	18.6	16.5	14.6	15.2	12.9	11.2	4.0	3.3	2.7
TechMahindra	815	ADD	101,559	2,377	59.1	71.0	84.4	13.8	11.5	9.7	12.3	8.6	6.6	2.7	1.9	1.4
Wipro	479	ADD	694,333	16,251	22.2	27.4	31.5	21.5	17.5	15.2	17.2	12.8	10.5	3.5	2.6	2.1
Technology		Neutral	3,470,071	81,219				19.8	16.8	14.7	15.7	12.7	10.5	3.7	2.9	2.4
KS universe (b)			35,208,065	824,062				17.5	15.4	12.4	11.1	9.7	7.8	2.1	1.7	1.4

Company	Target Price	(07P/E) / Egth O/S shares		EPS growth (%)			Net Profit (Rs mn)			EBITDA (Rs mn)			Sales (Rs mn)		
		(X)	(mn)	2008E	2009E	2010E	2007	2009E	2010E	2007	2009E	2010E	2007	2009E	2010E
HCL Technologies	260	1.79	695	(2.5)	17.8	12.9	12,777	15,048	16,987	15,483	17,962	21,262	74,806	91,034	109,101
Hexaware Technologies	70	4.38	142	(13.7)	1.3	20.9	72	1,115	1,348	1,201	1,364	1,645	10,398	11,918	14,130
Infosys Technologies	1,800	1.38	574	18.0	19.8	14.1	45,380	54,361	62,027	52,380	63,207	73,948	166,920	205,516	247,682
Mindtree	480	7.40	39	14.8	24.3	18.5	1,092	1,326	1,538	1,254	1,702	2,028	7,398	9,490	11,596
Mphasis BFL	200	0.61	208	67.6	10.1	18.8	2,553	2,810	3,338	4,181	4,624	5,560	24,231	29,448	36,666
Patni Computer Systems	270	3.13	139	27.4	(26.7)	15.8	4,554	3,339	3,867	4,762	4,347	5,321	26,485	28,486	32,414
Polaris Software Lab	85	38.53	98	(27.6)	20.6	15.7	732	883	1,022	1,182	1,404	1,586	10,993	12,422	13,789
Satyam Computer Services	500	1.08	682	17.7	20.9	14.7	16,879	20,809	23,875	18,348	22,769	27,140	84,735	109,152	132,674
TCS	950	1.18	979	21.5	12.8	13.1	50,191	56,640	64,039	59,397	68,782	76,651	228,614	272,494	314,913
TechMahindra	900	0.82	125	25.7	20.3	18.7	7,753	9,307	11,051	8,258	11,025	13,241	37,661	50,208	63,194
Wipro	490	1.28	1,450	12.6	23.3	14.8	32,237	39,759	45,654	39,670	50,227	58,609	197,428	250,521	297,076
Technology				17.5	17.9	14.2	174,999	206,292	235,685	207,343	248,860	288,620	878,206	1,080,802	1,285,157
KS universe (b)				28.5	13.8	24.5									

Note

(a) HCL Technologies is June fiscal year-ending

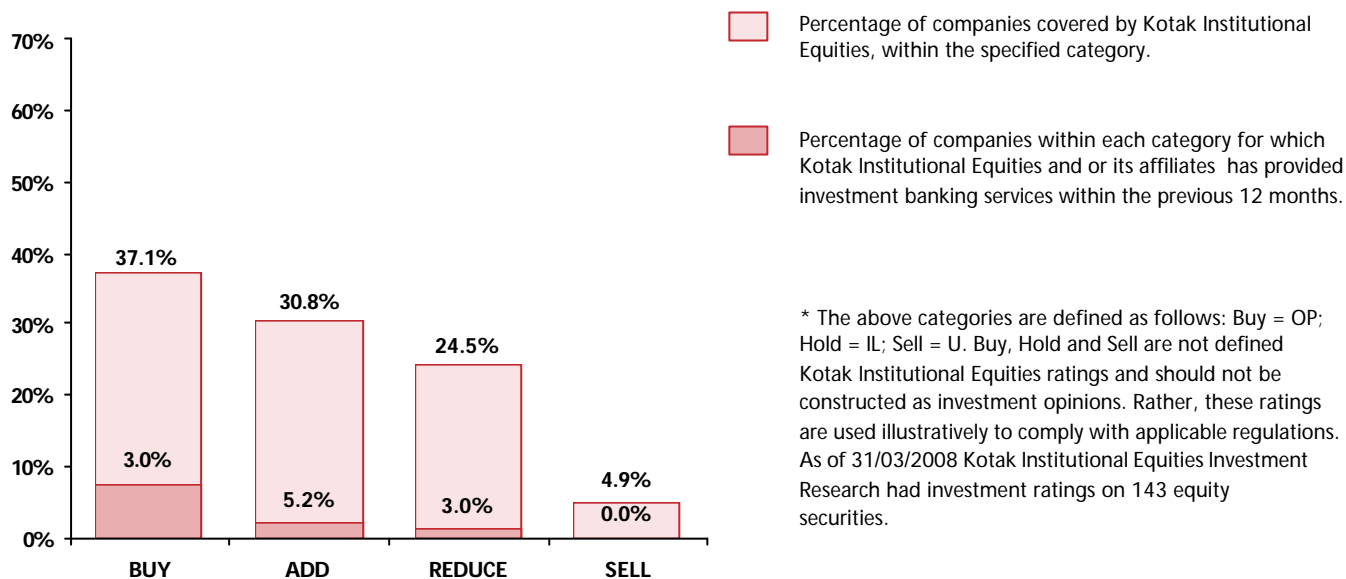
(b) Patni Computers Systems and Hexaware Technologies are December year-ending.

Source: Company reports, Kotak Institutional Equities estimates.

"Each of the analysts named below hereby certifies that, with respect to each subject company and its securities for which the analyst is responsible in this report, (1) all of the views expressed in this report accurately reflect his or her personal views about the subject companies and securities, and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report: Nischint Chawathe, Kawaljeet Saluja."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



* The above categories are defined as follows: Buy = OP; Hold = IL; Sell = U. Buy, Hold and Sell are not defined Kotak Institutional Equities ratings and should not be constructed as investment opinions. Rather, these ratings are used illustratively to comply with applicable regulations. As of 31/03/2008 Kotak Institutional Equities Investment Research had investment ratings on 143 equity securities.

Source: Kotak Institutional Equities.

As of March 31, 2008

Ratings and other definitions/identifiers

New rating system

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

REDUCE: We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

SELL: We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Old rating system

Definitions of ratings

OP = Outperform. We expect this stock to outperform the BSE Sensex over the next 12 months.

IL = In-Line. We expect this stock to perform in line with the BSE Sensex over the next 12 months.

U = Underperform. We expect this stock to underperform the BSE Sensex over the next 12 months.

Our target price are also on 12-month horizon basis.

Other definitions

Coverage view. The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive (A), Neutral (N), Cautious (C).

Other ratings/identifiers

NR = Not Rated. The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.

CS = Coverage Suspended. Kotak Securities has suspended coverage of this company.

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